

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other				Local Unit Name PATHWAYS	County MARQUETTE
Fiscal Year End 9/30/06		Opinion Date 5/29/07		Date Audit Report Submitted to State 6/29/07	

We affirm that:

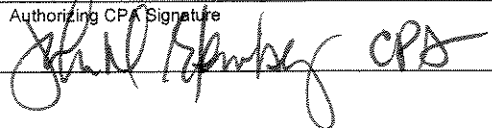
We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

- Check each applicable box below.** (See instructions for further detail.)
- | | YES | NO | |
|-----|-------------------------------------|-------------------------------------|---|
| 1. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary. |
| 2. | <input type="checkbox"/> | <input checked="" type="checkbox"/> | There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures. |
| 3. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury. |
| 4. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | The local unit has adopted a budget for all required funds. |
| 5. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | A public hearing on the budget was held in accordance with State statute. |
| 6. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division. |
| 7. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit. |
| 8. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | The local unit only holds deposits/investments that comply with statutory requirements. |
| 9. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the <i>Bulletin for Audits of Local Units of Government in Michigan</i> , as revised (see Appendix H of Bulletin). |
| 10. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover. |
| 11. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | The local unit is free of repeated comments from previous years. |
| 12. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | The audit opinion is UNQUALIFIED. |
| 13. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP). |
| 14. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | The board or council approves all invoices prior to payment as required by charter or statute. |
| 15. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | To our knowledge, bank reconciliations that were reviewed were performed timely. |

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>		
Other (Describe)	<input checked="" type="checkbox"/>	FFA	
Certified Public Accountant (Firm Name) ANDERSON, JACKMAN & CO. P.C.		Telephone Number 1-906-225-1166	
Street Address 102 N. WASHINGTON ST. SUITE 109		City MARQUETTE	State MI
Authorizing CPA Signature 		Printed Name JOHN W. BLUMBERG	Zip 49855
		License Number 1101010180	

**Pathways
Financial Statements
September 30, 2006**

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ANDERSON, TACKMAN & COMPANY, P.L.C.

CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITOR'S REPORT

Members of the Board
Pathways
Marquette, Michigan 49855

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2006, which collectively comprise the Pathways' basic financial statements as listed in the foregoing table of contents. These financial statements are the responsibility of the Pathways' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways as of September 30, 2006, and the respective changes in financial position and the cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 29, 2007, on our consideration of Pathways internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis and budgetary comparison information on pages 5 through 9 and 33 through 34, respectively, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Members of the Board
Pathways
Marquette, Michigan 49855

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Pathways basic financial statements. The other supplementary information listed in the table of contents is presented for the purpose of additional analysis and is not a required part of the basic financial statements of Pathways. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Anderson, Tackman & Company, PLLC
Certified Public Accountants

May 29, 2007

Pathways

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Our discussion and analysis of Pathways financial performance provides an overview of Pathways financial activities for the year ended September 30, 2006. Please read it in conjunction with the financial statements, which begin on page 10.

FINANCIAL HIGHLIGHTS

- Net assets for Pathways as a whole were reported at \$(167,853). Net assets are comprised of 100% governmental activities.
- During the year, Pathways expenses were \$83,005,241, while revenues from all sources totaled \$82,516,939, resulting in a decrease in net assets of \$488,302.
- The general fund reported a decrease in fund balance of \$577,637. Revenues were \$1 below the budgeted amount of \$82,522,218 and expenditures and transfers out were equal to the budgeted amount of \$83,099,854.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 10 and 11) provide information about the activities of Pathways as a whole and present a longer-term view of Pathways finances. Fund financial statements start on page 12. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for the future spending. Fund financial statements also report Pathways operations in more detail than the government-wide statements by providing information about Pathways most significant funds.

Reporting Pathways as a Whole

Our analysis of Pathways as a whole begins on page 6. One of the most important questions asked about Pathways' finances is "Is Pathways as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about Pathways as a whole and about its activities in a way that helps answer this question. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. These two statements report Pathways' *net assets* and changes in them. You can think of Pathways net assets - the difference between assets and liabilities - as one way to measure Pathways' financial health, or *financial position*. Over time, *increases or decreases* in Pathways' net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in Pathways' client base and the condition of Pathways' capital assets, to assess the *overall financial health* of Pathways.

In the Statement of Net Assets and the Statement of Activities, we divide Pathways into two kinds of activities:

- Government activities – All of Pathways basic services are reported here including client services and general administration. Medicaid and Department of Community Health revenues and other state and federal grants fund most of these activities.

Pathways

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (Continued)

- Business-type activities- Pathways currently does not engage in any business-type activities defined as activities financed by fees charged to external parties who use certain goods or services.

Reporting Pathways' Most Significant Funds

Our analysis of Pathways' major funds begins on page 8. The fund financial statements begin on page 12 and provide detailed information on the most significant funds – not Pathways as a whole. Some funds are required to be established by State law, and by bond covenants. However, the Pathways Board has established other funds to help it control and manage money for particular purposes. Pathways' two kinds of funds - *governmental* and *proprietary* – use different accounting methods.

- *Governmental funds* – Most of Pathways' services are reported in governmental funds which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other financial assets that can be readily converted into cash. The governmental fund statements provide a detailed *short-term* view of Pathways' general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance Pathways' programs. We describe the relationship (or differences) between *governmental activities* (reported in the Statement of Net Assets and Statement of Activities) and *governmental funds* in a reconciliation which follows the fund financial statements.
- *Proprietary funds* – When Pathways charges customers for the services it provides – whether to outside customers or to other units of Pathways – these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. We use internal service funds (the only component of Pathways proprietary funds) to report activities that provide supplies and services for Pathways other programs and activities – such as Pathways' Employee Benefit Fund, Medicaid Risk Reserve Fund and Equipment Fund.

Pathways as a Whole

Table 1 provides a summary of Pathways' net assets at September 30, 2006 and 2005:

**Table 1
Net Assets**

	Governmental Activities - 2006	Governmental Activities - 2005
Current assets	\$4,918,360	\$3,904,520
Capital assets, net	<u>5,690,896</u>	<u>5,953,549</u>
Total Assets	<u>10,609,256</u>	<u>9,858,069</u>
Current liabilities	6,442,190	4,956,520
Noncurrent liabilities	<u>4,334,919</u>	<u>4,571,899</u>
Total Liabilities	<u>10,777,109</u>	<u>9,528,419</u>
Net Assets:		
Invested in capital assets, net of related debt	2,367,444	2,304,548
Restricted	784,005	773,146
Unrestricted (deficit)	<u>(3,319,302)</u>	<u>(2,748,044)</u>
Total Net Assets	<u>\$ (167,853)</u>	<u>\$ 329,650</u>

Pathways

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (Continued)

Net assets of Pathways' governmental activities stood at \$(167,853). Unrestricted net assets—the part of net assets that could be used to finance day-to-day activities without constraints established by debt covenants, enabling legislation, or other legal requirements stood at a \$(3,319,302) deficit.

The results of this year's operations for the Board as a whole are reported in the Statement of Activities (see Table 2), which shows the changes in net assets for fiscal years 2006 and 2005.

Table 2
Changes in Net Assets

	Governmental Activities - 2006	Governmental Activities - 2005
Revenues:		
Program revenues:		
Charges for services	\$321,493	\$537,740
Operating grants and contributions	77,561,553	69,233,697
General revenues:		
State sources not restricted to specific program	4,057,082	3,089,392
Investment earnings	68,914	14,125
Gain (loss) on sale of capital assets	81,084	92,952
Miscellaneous	<u>426,813</u>	<u>255,474</u>
Total Revenues	<u>82,516,939</u>	<u>73,223,380</u>
Expenses:		
General government	82,995,132	74,908,867
Interest on long-term debt	<u>10,109</u>	<u>29,411</u>
Total Expenses	<u>83,005,241</u>	<u>74,938,278</u>
Change in net assets	(488,302)	(1,714,898)
Net assets, beginning	329,650	2,060,158
Prior period adjustments	<u>(9,201)</u>	<u>(15,610)</u>
Net Assets, Ending	<u>\$(167,853)</u>	<u>\$329,650</u>

Pathways' total revenues were \$82,516,939. The total cost of all programs and services was \$83,005,241, resulting in a decrease in net assets of \$488,302. This deficit can be attributed to two main operational areas, contract residential services and state and community inpatient care. Both of these areas have traditionally been problems for Pathways. Management of residential care has become more complex due to the State's decision to "unbundle" the services that are provided by these contractors. Unbundling requires that services previously provided under one service code be broken out separately. This provides us with both a problem and an opportunity. We can now more clearly see exactly which services are being provided, as well as their level of intensity (low, medium, or high). There is, however, a lack of good historical data to use as a basis for the rate calculation. State inpatient services have been an issue due to differences regarding suitability of placement and discharge criteria. Local inpatient services are extremely hard to predict, and also suffer from differences of opinion regarding diagnosis and treatment options. Pathways has taken steps to counteract these issues, both at the state and local levels, by initiating new procedures to both minimize hospitalizations and length of stay at inpatient facilities. Other expenses were in line with expectations; without the unexpected negative variances in residential and inpatient services, Pathways' change in net assets would have been positive.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (Continued)

Table 3 presents the cost of Pathways' major activity – General Government – as well as the program's net cost (total cost less revenues generated by the activities). The net cost shows the financial burden that this function placed on the Pathways operation.

Table 3
Governmental Activities

	2006		2005	
	Total Cost of Services	Net Cost of Services	Total Cost of Services	Net Cost of Services
General Government	<u>\$ 82,995,132</u>	<u>\$5,112,086</u>	<u>\$74,908,867</u>	<u>\$5,137,430</u>

PATHWAYS' FUNDS

As Pathways completed the year, its governmental funds (as presented in the balance sheet on page 12) reported a combined fund balance of \$(1,937,399), a decrease of \$576,049 from the beginning of the year and a prior period adjustment of \$9,201. Unexpected decreases in revenues and the inability to adjust the operational budget for these decreases contributed to the decrease in fund balance.

General Fund Budgetary Highlights

Over the course of the year, the Pathways Board revised the budget a few times. The purpose of these revisions is to recognize major changes in revenue or expenses. Expense and revenue budgets are corrected throughout the year based on actual year to date expenses and revenue as well as updated projections.

With these adjustments, actual charges to expenditures and transfers out were equal to the final amended budget. Conversely, revenues were \$1 lower than the final budget projection resulting in a \$577,637 decrease in fund balance compared to a planned decrease in fund balance of \$577,636. Higher than expected inpatient utilization and residential contract costs were the major contributors to this variance.

CAPITAL ASSET AND DEBT ADMINISTRATION**Capital Assets**

At the end of fiscal 2006, Pathways had \$5,690,896 invested in a variety of capital assets including buildings, vehicles and other equipment. (See table 4 below)

Table 4
Capital Assets at Year-End

	Governmental Activities - 2006	Governmental Activities - 2005
Land	\$540,694	\$547,694
Land improvements	-	-
Buildings	4,953,300	5,038,274
Building improvements	348,889	95,055
Leasehold improvements	10,364	-
Equipment and furnishings	2,592,023	2,810,417
Vehicles	1,254,588	1,492,778
Accumulated depreciation	<u>(4,008,962)</u>	<u>(4,030,669)</u>
Totals	<u>\$ 5,690,896</u>	<u>\$ 5,953,549</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (Continued)**Debt**

At year-end, Pathways had \$3,446,553 in notes outstanding as depicted in Table 5 below.

Table 5
Outstanding Debt at Year-End

	Governmental Activities - 2006	Governmental Activities - 2005
Installment contracts payable	\$139,065	\$244,110
Equipment notes payable	3,261,791	3,393,974
Line of credit	61,661	255,027
Totals	<u>\$3,462,517</u>	<u>\$3,893,111</u>

New additions to debt for this year include \$299,950 for equipment purchases. See Note J for further details on long-term debt.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

Pathways management and Board of Directors consider many factors when developing the fiscal 2007 budget. The first and primary consideration is the state of the Michigan economy and potential funding reductions. The state is entering the year with an increasing budget deficit due to lower than expected tax revenues. In past years with similar budget scenarios, Pathways has been protected from reductions in Medicaid and state general fund due to public mental health services being a core service of state government. We have no reason to expect that to change. FY 2007 will represent the first year of a five year plan required by the Michigan Treasury Department to address negative fund balances from FY 2005. A plan has been submitted and approved by the Michigan Treasury Department. A significant part of this plan is a reduction in operating expense combined with the sale of real property. In FY 2006, state general fund dollars were increased \$125,000 and verbal commitments received from the Department of Community Health for an additional \$200,000 in FY 2007. These allocations will move Pathways from an 80% level of average state funding in the CMH system to a 90% funding level. FY 2007 will see full year savings from contracting out four group homes to lower cost private non profit providers. FY 2007 will also see a significant reduction in psychiatric inpatient costs due to clinical interventions taking place and the aggressive placement of consumers out of state hospitals. FY 2007 will also see significant increased employee contribution to the Pathways self insured employee health plan.

CONTACTING PATHWAYS FINANCIAL MANAGEMENT

This financial report is designed to provide our clients, customers, and investors and creditors with a general overview of Pathways' finances and to show Pathways' accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Pathways Executive Director at Pathways, 200 West Spring Street, Marquette, Michigan, 49855.

Pathways

Statement of Net Assets

September 30, 2006

	<u>Governmental Activities</u>
ASSETS	
Current Assets:	
Cash and cash equivalents	\$ 8,421
Investments	2,391,817
Restricted assets	787,435
Receivables, net:	
Client fees	357,653
Other	799,301
Grants	80,824
Due from State of Michigan	144,265
Due from local units	-
Inventory	76,974
Prepaid expenses	271,670
Other assets	-
Total Current Assets	<u>4,918,360</u>
Noncurrent Assets:	
Capital assets:	
Land	540,694
Other capital assets	9,159,164
Accumulated depreciation	(4,008,962)
Total Noncurrent Assets	<u>5,690,896</u>
TOTAL ASSETS	<u>10,609,256</u>
LIABILITIES	
Current Liabilities:	
Cash overdraft	-
Accounts payable	2,399,890
Due to State of Michigan	1,178,709
Due to counties - liquor tax	712,364
Accrued payroll and related	1,053,241
Accrued retirement contribution	93,091
Other current liabilities	(78)
Deferred revenue	439,481
Notes payable	565,492
Total Current Liabilities	<u>6,442,190</u>
Noncurrent Liabilities:	
Compensated absences	1,437,894
Notes payable	2,897,025
Total Noncurrent Liabilities	<u>4,334,919</u>
TOTAL LIABILITIES	<u>10,777,109</u>
NET ASSETS	
Invested in capital assets, net of related debt	2,367,444
Restricted for:	
Medicaid savings carryforward	-
Medicaid risk reserve	773,945
Debt service	10,060
Unrestricted	(3,319,302)
TOTAL NET ASSETS	<u>\$ (167,853)</u>

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Statement of Activities

For the Fiscal Year Ended September 30, 2006

Function/Program	Expenses	Program Revenue			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
General government	\$ 82,995,132	\$ 321,493	\$ 77,561,553	\$ -	\$ (5,112,086)
Interest on long-term debt	10,109	-	-	-	(10,109)
Total Governmental Activities	\$ 83,005,241	\$ 321,493	\$ 77,561,553	\$ -	(5,122,195)
General revenues:					
State sources not restricted to specific program					4,057,082
Investment earnings					68,914
Gain (loss) on disposal of assets					81,084
Miscellaneous					426,813
Total general revenues					4,633,893
Changes in net assets					(488,302)
Net assets, beginning of year					329,650
Prior period adjustment for Medicaid risk carryforward					-
Prior period adjustment for contributions					-
Prior period adjustment for Medicaid settlements					(9,201)
Net assets, beginning of year, as restated					320,449
NET ASSETS, END OF YEAR					\$ (167,853)

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Governmental Funds Balance Sheet

September 30, 2006

	General Fund	Other Nonmajor Governmental Funds	Total Governmental Funds
ASSETS			
Cash and cash equivalents	\$ -	\$ 6,253	\$ 6,253
Investments	449,274	107,040	556,314
Accounts receivable:			
Client fees	357,653	-	357,653
Other	789,241	10,060	799,301
Grants receivable	80,824	-	80,824
Due from State of Michigan	144,265	-	144,265
Due from other funds	689,757	1,113	690,870
Inventory	76,974	-	76,974
Restricted assets	787,435	-	787,435
Prepaid expenditures	271,670	-	271,670
Other assets	-	-	-
TOTAL ASSETS	\$ 3,647,093	\$ 124,466	\$ 3,771,559
LIABILITIES AND FUND BALANCE			
LIABILITIES:			
Cash overdraft	\$ 5,590	\$ -	\$ 5,590
Accounts payable	2,399,890	-	2,399,890
Due to State of Michigan	1,178,709	-	1,178,709
Due to counties - liquor tax	712,364	-	712,364
Due to other funds	-	-	-
Accrued payroll and related	879,911	-	879,911
Accrued retirement contribution	93,091	-	93,091
Other current liabilities	(78)	-	(78)
Deferred revenue	439,481	-	439,481
TOTAL LIABILITIES	5,708,958	-	5,708,958
FUND BALANCE:			
Reserved for:			
Debt service	-	10,060	10,060
Unreserved, reported in:			
General Fund	(2,061,865)	-	(2,061,865)
Special Revenue Funds	-	114,406	114,406
TOTAL FUND BALANCE	(2,061,865)	124,466	(1,937,399)
TOTAL LIABILITIES AND FUND BALANCE	\$ 3,647,093	\$ 124,466	\$ 3,771,559

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets

September 30, 2006

Total Fund Balances for Governmental Funds	\$ (1,937,399)
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*Amounts reported for governmental activities in the statement
of net assets are different because:*

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	5,690,896
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Internal service funds are used by Pathways to charge the cost of equipment usage and employee benefits to the General Fund. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets, net of capital assets.	(3,782,285)
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Long-term liabilities, including notes payable, are not due and payable in the current period and therefore are not reported in the funds	(139,065)
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Net Assets of Governmental Activities	<hr/> \$ (167,853) <hr/>
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The accompanying notes to financial statements are an integral part of this statement.

Pathways

Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balance

For the Fiscal Year Ended September 30, 2006

	General Fund	Other Nonmajor Governmental Funds	Total Governmental Funds
REVENUES:			
State sources	\$ 77,187,058	-	\$ 77,187,058
Contracts and grants	2,807,198	-	2,807,198
Charges for services	1,938,485	-	1,938,485
Local sources	882,329	16,012	898,341
Investment income	66,083	2,831	68,914
Other	5,695,793	-	5,695,793
Less deductions from revenue:			
Donated services discounts	(6,780,767)	-	(6,780,767)
Local match - QAAP Assessment	-	-	-
Local match - Medicaid draw down	726,038	-	726,038
Public Act 423 of 1980	-	-	-
TOTAL REVENUES	82,522,217	18,843	82,541,060
EXPENDITURES:			
Current operations	82,984,670	8,255	82,992,925
Debt service:			
Principal	-	105,075	105,075
Interest and fiscal charges	-	10,109	10,109
Capital outlay	-	-	-
TOTAL EXPENDITURES	82,984,670	123,439	83,108,109
EXCESS REVENUES OVER (UNDER) EXPENDITURES	(462,453)	(104,596)	(567,049)
OTHER FINANCING SOURCES (USES):			
Loan proceeds	-	-	-
Transfers in	-	115,184	115,184
Transfers (out)	(115,184)	-	(115,184)
TOTAL OTHER FINANCING SOURCES (USES)	(115,184)	115,184	-
NET CHANGE IN FUND BALANCE	(577,637)	10,588	(567,049)
Fund balance, beginning of year	(1,475,027)	113,878	(1,361,149)
Prior period adjustment for contributions	-	-	-
Prior period adjustment for Medicaid settlements	(9,201)	-	(9,201)
Fund balance, beginning of year, as restated	(1,484,228)	113,878	(1,370,350)
FUND BALANCE, END OF YEAR	\$ (2,061,865)	\$ 124,466	\$ (1,937,399)

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balance of Governmental Funds to the Statement of Activities

For the Fiscal Year Ended September 30, 2006

Net Change in Fund Balances - Total Governmental Funds	\$	(567,049)
--	----	-----------

*Amounts reported for governmental activities in the statement
of activities are different because:*

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of depreciation expense recorded in the current period.	(79,622)
---	----------

Internal service funds are used by Pathways to charge the cost of equipment usage and employee benefits to the General Fund. The net revenue (expense) of the internal service funds is reported with governmental activities, net of depreciation expense of \$647,532	77,415
---	--------

Gain on disposal of capital assets is not reported in the governmental funds, but is reported in the statement of activities.	81,084
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Proceeds on sale of capital assets are reported in the governmental funds, but included in the gain on disposal of capital assets amount in the statement of activities.	(105,205)
--	-----------

Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.	105,075
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Change in Net Assets of Governmental Activities	\$	(488,302)
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The accompanying notes to financial statements are an integral part of this statement.

Pathways

Proprietary Funds Statement of Net Assets

September 30, 2006

	Internal Service Funds
ASSETS	
Current Assets:	
Cash and cash equivalents	\$ 7,758
Investments	1,835,503
Due from local units	-
Due from other funds	-
Total Current Assets	<u>1,843,261</u>
Capital Assets:	
Capital assets	5,614,258
Accumulated depreciation	(1,599,936)
Total Noncurrent Assets	<u>4,014,322</u>
TOTAL ASSETS	<u>5,857,583</u>
LIABILITIES	
Current Liabilities:	
Accounts payable	-
Due to other funds	690,870
Accrued payroll and related	173,330
Current maturities of long-term debt	502,795
Total Current Liabilities	<u>1,366,995</u>
Long-term Liabilities:	
Compensated absences	1,437,894
Notes payable	2,820,657
Total Long-term Liabilities	<u>4,258,551</u>
TOTAL LIABILITIES	<u>5,625,546</u>
NET ASSETS	
Invested in capital assets, net of related debt	-
Restricted	773,945
Unrestricted	(541,908)
TOTAL NET ASSETS	<u>\$ 232,037</u>

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Proprietary Funds Statement of Revenues, Expenses and Changes in Net Assets

For the Fiscal Year Ended September 30, 2006

	Internal Service Funds
OPERATING REVENUES:	
Charges for services	\$ 3,415,945
Other	-
TOTAL OPERATING REVENUES	<u>3,415,945</u>
OPERATING EXPENSES:	
Personnel services	2,540,913
Other services and charges	-
Depreciation	647,532
TOTAL OPERATING EXPENSES	<u>3,188,445</u>
OPERATING INCOME (LOSS)	<u>227,500</u>
NON-OPERATING REVENUES (EXPENSES):	
Interest income	44,841
Interest expense	(149,639)
Loss on disposal of assets	(45,287)
TOTAL NON-OPERATING REVENUES (EXPENSES)	<u>(150,085)</u>
CHANGE IN NET ASSETS	77,415
Net assets, beginning of year	<u>154,622</u>
NET ASSETS, END OF YEAR	<u>\$ 232,037</u>

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Proprietary Funds Statement of Cash Flows

For the Fiscal Year Ended September 30, 2006

	<u>Internal Service Funds</u>
CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash received from charges for services	\$ 3,415,945
Other operating revenues	-
Cash paid for operating expenses	<u>(2,573,487)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>842,458</u>
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:	
Decrease in due from other funds	-
Increase in due to other funds	166,609
Decrease in due from local units	-
Transfers from local units	<u>-</u>
NET CASH PROVIDED BY NON-CAPITAL FINANCING ACTIVITIES	<u>166,609</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:	
Acquisition and construction of capital assets	(533,879)
Proceeds on issuance of long-term debt	405,219
Interest payments on long-term debt	(149,639)
Principal payments on long-term debt	<u>(730,768)</u>
NET CASH PROVIDED BY CAPITAL FINANCING ACTIVITIES	<u>(1,009,067)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest income	57,686
Net (increase) in investments	(783,232)
(Increase) in fair market value of investments	<u>(12,845)</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>(738,391)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(738,391)
Cash and cash equivalents, beginning of year	<u>746,149</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 7,758</u></u>
RECONCILIATION OF OPERATING (GAIN) LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Net operating (loss)	<u>\$ 227,500</u>
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:	
Depreciation expense	647,532
Changes in assets and liabilities:	
(Decrease) in accounts payable	-
Increase in accrued sick and vacation	(18,722)
Increase in accrued payroll and related	<u>(13,852)</u>
TOTAL ADJUSTMENTS	<u>614,958</u>
NET CASH PROVIDED FROM OPERATING ACTIVITIES	<u><u>\$ 842,458</u></u>

The accompanying notes to financial statements are an integral part of this statement.

PATHWAYS
Notes to Financial Statements
For the year ended September 30, 2006

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Pathways is an autonomous entity, separate from the county governments which it services and accordingly consists of a separate set of self-balancing funds and accounts. Pathways is, for financial reporting purposes, an Authority under the Michigan Mental Health Code (P.A. 290 of 1995). The accounting policies of Pathways conform to generally accepted accounting principles as applicable to governments. The following is a summary of the more significant policies:

BASIS OF PRESENTATION

During the year Pathways adopted Governmental Accounting Standards Board (GASB) Statement No. 34, which substantially revised the financial statement presentation as described below.

Government-Wide Financial Statements:

The Statement of Net Assets and Statement of Activities display information about Pathways as a whole. They include all funds of Pathways. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through State sources, intergovernmental revenues, and other non-exchange revenues. Pathways currently does not engage in any business-type activities defined as activities financed in whole or in part by fees charged to external parties for goods or services. Equity is classified as net assets and displayed in three components – invested in capital assets, net of related debt, restricted, and unrestricted.

Fund Financial Statements:

The accounts of Pathways are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The various funds are grouped in the financial statements in this report into two major categories: governmental and proprietary categories. An emphasis is placed on major funds within the governmental category. The General Fund is always considered a major fund and the remaining funds of Pathways are considered major if the total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding total for all governmental funds in accordance with the criteria.

Pathways' reports the General Fund as its only major governmental fund in accordance with the above criteria. The funds of Pathways are described below:

Governmental Funds

General Fund – The General Fund is the main operating fund and accordingly, it is used to account for all financial resources except those required to be accounted for in another fund.

Debt Service Fund – The Debt Service Fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interest, and related costs.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Special Revenue Fund – The Special Revenue Fund is used to account for proceeds of specific revenue sources that are restricted to expenditures for specific purposes. The Ray of Sunshine Fund is a special revenue fund type.

Proprietary Funds

Internal Service Fund – The Internal Service Fund is used to account for the financing of goods or services provided by one department or agency to other departments or agencies of Pathways or to other governments, on a cost-reimbursement basis. The Employee Benefit Fund, Medicaid Risk Reserve Fund and Equipment Fund are internal service funds.

MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

Measurement focus is a term used to describe “which” transactions are recorded within the various financial statements. Basis of accounting refers to “when” transactions are recorded regardless of the measurement focus applied.

Measurement Focus

On the government-wide Statement of Net Assets and the Statement of Activities, the governmental activities are presented using the economic resource measurement focus as defined in item (b) below. In the fund financial statements, the “current financial resources” measurement focus or the “economic resources” measurement focus is used as appropriate:

- a. All governmental funds utilize a “current financial resources” measurement focus. Only current financial assets and liabilities are generally included on their balance sheets. Their operating statements present sources and uses of available spendable financial resources during a given period. These funds use fund balance as their measure of available spendable resources at the end of the period.
- b. The proprietary funds utilize an “economic resources” measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets, financial position and cash flows. All assets and liabilities, whether current or noncurrent, associated with their activities are reported. Proprietary fund equity is classified as net assets.

Basis of Accounting

In the government-wide Statement of Net Assets and Statement of Activities, governmental activities are presented using the accrual basis of accounting. Also, the proprietary fund financial statements are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

In the fund financial statements, governmental funds are presented on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when “measurable and available.” Measurable means knowing or being able to reasonably estimate the amount. Available means collectible within the current period or within sixty days after year-end. Expenditures, including capital outlay, are generally recognized when the related fund liability is incurred.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

OTHER SIGNIFICANT ACCOUNTING POLICIES

Cash and Equivalents

Pathways cash and cash equivalents as reported in the Statement of Cash Flows and the Statement of Net Assets are considered to be cash on hand, demand deposits and short-term investments with maturities of three months or less when purchased.

Receivables

All receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible.

Interfund Activity

During the course of its operations, Pathways has numerous transactions between funds to finance operations, to provide services and to service debt. To the extent that certain transactions between funds had not been paid or received as of September 30, 2004, balances of interfund accounts receivable or payable have been recorded in the fund financial statements. Interfund activity is eliminated in the government-wide financial statements.

Inventory

Inventory is valued at the lower of cost (first-in, first-out) or market. Inventory in the General Fund consists of expendable supplies.

Capital Assets

The accounting and reporting treatment applied to capital assets associated with a fund are determined by its measurement focus. In the fund financial statements, capital assets used in governmental fund operations are accounted for as capital outlay expenditures of the governmental fund upon acquisition. Capital assets used in proprietary fund operations are accounted for the same as in the government-wide financial statements.

In the government-wide financial statements, all capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are valued at their estimated fair value on the date donated. Pathways defines capital assets as assets with an initial, individual cost of more than \$5,000.

Depreciation of all exhaustible capital assets is recorded as an allocated expense in the Statement of Activities, with accumulated depreciation reflected in the Statement of Net Assets. Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation. The range of estimated useful lives by type of asset is as follows:

Buildings	25-40 years
Vehicles and equipment	3-15 years

The cost of normal maintenance and repairs is charged to operations as incurred. Renewals and betterments are capitalized and depreciated over the remaining useful lives of the related properties.

Long-Term Debt

The accounting treatment of long-term debt depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements. All long-term debt to be repaid from

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

governmental or business-type resources are reported as liabilities in the government-wide statements. Pathways long-term debt consists primarily of notes payable.

Long-term debt for governmental funds is not reported as liabilities in the fund financial statements. The debt proceeds are reported as other financing sources and payments of principal and interest are reported as expenditures. The accounting for proprietary funds is the same in the fund statements as it is in the government-wide statements.

Compensated Absences

Pathways' policies regarding compensated absences permits employees to accumulate earned but unused paid time off, compensation and sick time. The liability for these compensated absences is recorded as long-term debt in the government-wide statements. In the fund financial statements, governmental funds report only the compensated absence liability payable from expendable available financial resources, while proprietary funds report the liability as it is incurred.

Deferred Revenues

In the government-wide statements and proprietary fund financial statements, deferred revenue is recognized when cash, receivables or other assets are received prior to their being earned. In the governmental fund statements, deferred revenue is recognized when revenue is unearned or unavailable. Pathways has reported deferred revenue of \$170,785 in the General Fund for Department of Community Health Medicaid and General Funding that has been received but is unearned.

Revenues

In the government-wide Statement of Activities, revenues are segregated by activity and are classified as either a program revenue or a general revenue. Program revenues include charges to customers or applicants for goods or services, operating grants and contributions and capital grants and contributions. General revenues include all revenues, which do not meet the criteria of program revenues and include revenues such as State funding and interest earnings.

In the governmental fund statements, revenues are reported by source, such as federal sources, state sources and charges for services. Revenues consist of general purpose revenues and restricted revenues. General purpose revenues are available to fund any activity reported in that fund, while restricted revenues are available for a specific purpose or activity and the restrictions are typically required by law or a grantor agency. When both general purpose and restricted revenues are available for use, it is the Pathways policy to use the restricted resources first.

Expenses/Expenditures

In the government-wide Statement of Activities, expenses are segregated by activity and are classified by function. In the governmental fund statements, expenditures are classified by character such as current operations, debt service and capital outlay. In the proprietary fund statements, expenses are classified by operating and non-operating and are sub-classified by function such as personnel services and other services and charges.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Budgets and Budgetary Accounting

Pathways follows these procedures in establishing the budgetary data reflected in the financial statements:

- a. Prior to October 1, the Executive Director submits to the Board a proposed operating budget for the fiscal year commencing the following October 1. The operating budget includes proposed expenditures and the means of financing them.
- b. Prior to October 1, the budget is legally enacted through passage of a Board resolution.
- c. The Executive Director is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures of any fund must be approved by the Board.
- d. Budgets are adopted on a basis consistent with generally accepted accounting principles. Budgeted amounts are as originally adopted, or as amended by the Board. Individual amendments were not material in relation to the original appropriations which were amended.
- e. Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is not employed by Pathways because it is at present considered not necessary to assure effective budgetary control or to facilitate effective cash planning and control. Any unexpendable appropriations lapse at the end of the fiscal year.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

NOTE B – DEPOSITS AND INVESTMENTS:

The composition of cash and equivalents and investments as reported in the government-wide Statement of Net Assets is presented below:

	<u>Cash</u>	<u>Investments</u>	<u>Total</u>
Unrestricted	\$8,421	\$2,391,817	\$2,400,238
Restricted assets	<u>188,610</u>	<u>598,825</u>	<u>787,435</u>
	<u>\$197,031</u>	<u>\$2,990,642</u>	<u>\$3,187,673</u>

Cash and cash equivalents can also be summarized into the following categories:

Deposits:	
Cash in demand accounts	\$(105,409)
Cash in savings accounts	<u>302,440</u>
	<u>\$197,031</u>

NOTE B – DEPOSITS AND INVESTMENTS (Continued):

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, Pathways' deposits may not be returned to it. State law does not require and Pathways does not have a deposit policy for custodial credit risk. The carrying amounts of Pathways' deposits with financial institutions was \$197,031 and the bank balance was \$710,178. Of the bank balance, \$85,462 or approximately 12% was covered by federal depository insurance according to FDIC regulations.

Investments

As of June 30, 2006, Pathways had the following investments.

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment in Maturities (in Years)</u>		
		<u>Less Than 1</u>	<u>1-5</u>	<u>6-10</u>
Certificates of Deposit	<u>\$2,990,642</u>	<u>\$1,167,488</u>	<u>\$1,771,725</u>	<u>\$51,429</u>

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of Pathways' investments. Pathways does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk

Michigan statutes (Act 196, PA 1997) authorize Pathways to invest in bonds, other direct obligations and repurchase agreements of the United States, certificates of deposits, savings accounts, deposit accounts or receipts of a bank which is a member of the FDIC and authorized to operate in this state, commercial paper rated at the time of purchase within the two highest classifications established by not less than two standard rating services and matures within 270 days from date of purchase, bankers' acceptances of the United States banks, obligations of the State of Michigan and its political subdivisions, external investment pools, and certain mutual funds. Michigan law prohibits security in the form of collateral, surety bond, or another form for the deposit of public money.

Pathways has no investment policy that would further limit its investment choices. Ratings are not required for the type of investments listed above. Pathways investments are in accordance with statutory authority.

NOTE C – ESTIMATED AMOUNT DUE FROM (TO) MICHIGAN DEPARTMENT OF COMMUNITY HEALTH:

The estimated amount due from (to) the Michigan Department of Community Health represents the Board's cost settlement report of services and expenditures for the year ending September 30, 2006 in accordance with the terms of the master contract. The reported costs related to such services are subject to review by the Department.

NOTE D – CAPITAL ASSETS:

All capital assets are recorded at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are valued at their estimated fair value on the date donated. Capital asset activity for the year ended September 30, 2006 is as follows:

NOTE D – CAPITAL ASSETS (Continued):

	Balance at 10/01/05	Additions	Disposals	Adjustments	Balance at 9/30/06
Capital assets not being depreciated:					
Land	\$ 547,694	\$ -	\$ 7,000	\$-	\$540,694
Capital assets being depreciated:					
Buildings	5,038,274	-	84,974	-	4,953,300
Building improvements	95,055	255,529	1,695	-	348,889
Leasehold improvements	-	10,364	-	-	10,364
Equipment and furnishings	2,810,417	159,092	377,486	-	2,592,023
Vehicles	1,492,778	108,894	347,084	-	1,254,588
Total Capital Assets	<u>9,984,218</u>	<u>533,879</u>	<u>818,239</u>	<u>-</u>	<u>9,699,858</u>
Less accumulated depreciation:					
Buildings	1,271,529	186,609	27,192	(18,080)	1,412,866
Building improvements	48,843	17,743	1,695	-	64,891
Leasehold improvements	-	230	-	-	230
Equipment and furnishings	1,673,821	328,799	370,349	(28,324)	1,603,947
Vehicles	1,036,476	193,773	303,221	-	927,028
Total Accumulated Depreciation	<u>4,030,669</u>	<u>727,154</u>	<u>702,457</u>	<u>(46,404)</u>	<u>4,008,962</u>
Capital Assets, net	<u>\$5,953,549</u>	<u>\$(193,275)</u>	<u>\$115,782</u>	<u>\$46,404</u>	<u>\$5,690,896</u>

Depreciation expense was charged to governmental activities as follows:

Governmental Activities:	
General government	\$79,622
Internal service funds charged to above activities	647,532
Total	<u>\$727,154</u>

NOTE E – UNPAID CLAIMS:

The Board estimates its liability for unpaid health insurance claims on the basis of the date the claim was incurred and historical experience. As of September 30, 2006, the amount of unpaid claims in the accompanying financial statements is \$173,330.

NOTE F – INTERNAL SERVICE FUND ACCRUED LIABILITIES:

Prior to March 10, 1997 regular employees annually earned hours of sick leave. For those employees hired before October 1, 1981 the sick leave was paid out upon termination or retirement at a rate of 50% of the sick leave balance to a maximum of 600 hours (1,200 hours x 50%). For those employees hired after October 1, 1981 the payment was paid out only upon retirement, vesting under both situations occurred after 10 years of service.

The new policy, which became effective March 10, 1997, accrues all employees' sick annual, bonus and personal leave in one leave bank, referred to as Paid Time Off (PTO). In addition to PTO, each full time employee will be given 32 hours of paid, extended/restricted sick leave per year to be used only for major medical events. Extended/Restricted sick leave cannot accrue; therefore, there will be no pay out of this sick leave at retirement or termination. An employee may earn one extra bonus day of PTO per year.

Separation from service entitles the employee to payment of the available balance of PTO leave, up to 40 hours compensation time, plus any unused sick leave according to policies in place prior to March 10, 1997.

NOTE F – INTERNAL SERVICE FUND ACCRUED LIABILITIES (Continued):

The amount of vested leave as of September 30, 2006 is as follows:

Paid time off	\$1,262,577
Sick Leave	150,253
Compensation Time	<u>25,064</u>
TOTAL	<u>\$1,437,894</u>

NOTE G – LINE OF CREDIT:

As of September 30, 2005, Pathways had a secured credit agreement with maximum borrowings of \$300,000 to be utilized for equipment purchases by October 20, 2005. At September 30, 2006, the outstanding balance was \$61,661 as reported in the Internal Service Building & Equipment Fund and is currently payable until a loan agreement is secured. The interest rate is 4.95% per annum.

A summary of changes in short-term debt for the year ended September 30, 2006 is as follows:

	Balance <u>10/1/05</u>	<u>Additions</u>	<u>Deductions</u>	Balance <u>9/30/06</u>
Line of Credit - General	\$ -	\$ -	\$ -	\$ -
Line of Credit – Equipment	<u>255,027</u>	<u>105,269</u>	<u>298,635</u>	<u>61,661</u>
Totals	<u>\$255,027</u>	<u>\$105,269</u>	<u>\$298,635</u>	<u>\$61,661</u>

NOTE H – DEFERRED COMPENSATION PLANS:

Pathways offers its employees deferred compensation plans created in accordance with Section 457 of the Internal Revenue Code. The plans, available to all employees, permit them to defer a portion of their current salary until future years. The deferred compensation is not available to the employees until termination, retirement, death or unforeseeable emergency.

The amounts deferred under the plan are held in a custodial account for the exclusive benefit of plan participants and their beneficiaries. The plans' participants have the right to designate how the funds will be invested. Therefore, Pathways has no liability for losses under the plans.

Due to changes in the Internal Revenue Code, the plans' assets are considered to be property of the plans' participants and are no longer subject to Pathways general creditors. Therefore, in accordance with GASB Statement No. 32, plan balances and activities are not reflected in these financial statements.

NOTE I – DEFINED CONTRIBUTION PENSION PLAN:

Pathways provides pension benefits to employees through four defined contribution pension plans, as listed below. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Pathways established the plans in the form of the ICMA Retirement Corporation Governmental Money Purchase Plan and Trust, as amended by and as authorized by Section 19A of the Municipal Employee's Retirement System of Michigan Plan Document. The ICMA Retirement Corporation is the Plan Administrator and Pathways has agreed to the commingled investment of assets of the Plan within the ICMA Retirement Trust.

NOTE I – DEFINED CONTRIBUTION PENSION PLAN (Continued):

	<u>FICA Alternative</u>	<u>VEMA</u>	<u>Retirement Non- Bargaining</u>	<u>Retirement - Delta Technical/ Support Unit</u>	<u>Retirement- Delta Professional Unit</u>
Employees Covered	All regular status full and part-time employees	All non-union regular status full and part-time employees	All regular status non-bargaining full and part time employees hired after 1/1/98	All 3/4 time, full time, and job-share status bargaining technical and support staff employees hired after 4/7/99	All 3/4 time, full time, and Job-share status bargaining Professional staff employees hired after 4/9/99
Number of Plan Members	272	141	99	20	14
Mandatory Employee Contributions	None	None	None	None	None
Mandatory Employer Contributions	5.00% or 6.20%	1.20%	5.00%	5.00%	5.00%
Vesting Requirements	Immediate	Immediate	4 years (25% per year)	4 years (25% per year)	4 years (25% per year)
Actual Employee Contributions	\$26,650	\$0	\$2,523	\$200	\$0
Actual Employer Contributions	<u>644,037</u>	<u>87,099</u>	<u>194,606</u>	<u>42,234</u>	<u>34,918</u>
Total Contributions	<u>\$670,687</u>	<u>\$87,099</u>	<u>\$197,129</u>	<u>\$42,434</u>	<u>\$34,918</u>

NOTE J – LONG-TERM DEBT:

Changes in long-term debt principal during the year ended September 30, 2006 are summarized as follows:

	<u>Balance 10/1/05</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance 9/30/06</u>
Installment contracts	\$244,110	\$ -	\$105,045	\$139,065
Equipment Fund – Notes payable	<u>3,393,974</u>	<u>299,950</u>	<u>432,133</u>	<u>3,261,791</u>
Total Long-Term Debt	<u>\$3,638,084</u>	<u>\$299,950</u>	<u>\$537,178</u>	<u>\$3,400,856</u>

NOTE J – LONG-TERM DEBT (Continued):

Long-term debt at September 30, 2006 consists of the following:

	Issue Date	Original Amount	Interest Rate	Monthly Payment	Principal	Interest	Total
Installment Contracts:							
Maple Ridge	04/06/1995	\$170,346	70% Bank Base Rate	\$1,507.33	\$29,353	\$4,310	\$33,663
Wood Ridge	05/01/1995	140,765	70% Bank Base Rate	1,218.12	30,706	4,863	35,569
Baraga Street	03/01/1996	48,500	6.40%	420.00	11,947	1,419	13,366
Spring Street	01/01/1996	93,000	5.80%	775.00	26,500	3,177	29,677
Lincoln House and Lake Bluff	06/23/1998	186,410	5.61%	2,034.00	40,559	2,111	42,670
Total Installment Contracts					<u>139,065</u>	<u>15,880</u>	<u>154,945</u>
Equipment Fund -							
Notes Payable:							
Phone System	02/22/2002	643,000	4.90%	9,075.28	246,950	15,237	262,187
Vehicle	10/01/2002	21,340	0.00%	355.66	3,913	-	3,913
Vehicle	10/01/2002	21,009	0.00%	350.16	3,852	-	3,852
Equipment	08/26/2004	464,350	3.45%	10,389.91	230,062	7,998	238,060
Cedar Hills, North Bluff, Gwinn	06/22/2004	448,233	3.95%	2,381.92	427,050	215,974	643,024
DeFant Building	10/05/2004	2,050,000	5.10%	16,318.26	1,866,640	687,393	2,554,033
Equipment	05/27/2005	174,861	3.65%	3,927.05	122,810	6,059	128,869
Equipment	04/24/2006	299,950	4.95%	6,911.10	271,380	25,338	296,718
Great Plains System	06/24/2005	145,855	0.00%	4,051.53	89,134	-	89,134
Total Notes Payable					<u>3,261,791</u>	<u>957,999</u>	<u>4,219,790</u>
					<u>\$3,400,856</u>	<u>\$973,879</u>	<u>\$4,374,735</u>

As of September 30, 2006, the aggregate maturities of long-term debt are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$565,492	\$149,067	\$715,511
2008	554,790	125,043	679,833
2009	301,148	104,124	405,272
2010	183,196	91,476	274,672
2011	140,880	83,522	222,402
2012-2016	819,856	302,155	1,122,011
2017-2021	648,716	90,041	738,757
2022-2026	117,749	25,166	142,915
2027-2030	<u>69,029</u>	<u>3,285</u>	<u>71,362</u>
TOTALS	<u>\$3,400,856</u>	<u>\$973,879</u>	<u>\$4,374,735</u>

NOTE K – DEFICIT NET ASSETS/FUND BALANCE:

The General Fund had a deficit in total fund balance at September 30, 2006 of \$(2,061,865). Pathways' position is that the deficit is a result of under-estimating allowance for doubtful accounts in prior years and reduction in Medicaid funding below costs of providing services. Pathways plans to reduce the deficit through reduction in costs.

The Employee Benefit Fund had a deficit in total net assets at September 30, 2006 of \$(541,908). Pathways' position is that a deficit exists and at present they are unable to remedy the issue. However, Pathways periodically calculates the value of this liability charging or crediting the Fund as appropriate. Pathways plans to reduce the unfunded liability each year to the extent that state and local funding is available.

NOTE L – MEDICAID REIMBURSEMENTS:

Effective October 1, 1998, Pathways entered into a Specialty Community Mental Health Services and Supports Managed Care Contract with the Michigan Department of Community Health (MDCH). Under the Managed Care Contract, the MDCH provides Pathways' state and federal share of Medicaid funds as a capitated payment based on a Per Eligible Per Month methodology for contractually identified and described covered services. Each month of the contract, Pathways receives a prepayment based upon the number of eligibles for that month. This payment methodology replaced the Medicaid reimbursement system in effect through September 30, 1998. In accordance with the contract, Pathways may retain up to 5% of the prepayment as Medicaid savings which are allowed to be treated as local funds and must be expended in the following year. The Medicaid savings must be included in a formal reinvestment strategy which must be directed to the Medicaid population and must be approved by the MDCH.

NOTE M – TRANSFERS IN (OUT):

	Transfer In		Transfer Out
Debt Service Fund	\$115,184	General Fund	\$115,184
TOTALS	<u>\$115,184</u>	TOTALS	<u>\$115,184</u>

NOTE N – DEFINED BENEFIT RETIREMENT PLAN:

The following information is based upon the latest available actuarial valuation (as of December 31, 2005).

Plan Description

Pathways contributes to the Municipal Employees Retirement System of Michigan (System), an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for all Michigan municipal employees. The System issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to MERS at 1134 Municipal Way, Lansing, MI 48917-9755.

All regularly scheduled full and part-time employees of Pathways are eligible to participate in the System. Benefits vest after ten years of service. Pathways employees who retire at or after the age of 60 with 10 years of credited service are entitled to an annual retirement benefit, payable monthly for life, in an amount equal to the sum of 2.25 percent of a member's final average compensation times years of service, with a maximum benefit of 80% of final average compensation. The System also provides death and disability benefits. These benefit provisions and all other requirements are

NOTE N – DEFINED BENEFIT RETIREMENT PLAN (Continued):

established by State statute and Pathways' Board.

Funding Policy

Employees of Pathways at present are required to contribute two percent of their annual salary to the System. Pathways is currently contributing the remaining amounts necessary to fund the System, using the actuarial basis specified by statute.

Annual Pension Cost

For the year ended September 30, 2006, Pathways' annual pension cost of \$1,298,472 for the plan was equal to Pathways' required and actual contribution. The annual required contribution was determined as part of an actuarial valuation at December 31, 2003 using the entry age normal cost method. Significant actuarial assumptions used in the valuation include (a) a rate of return on the investment of present and future assets of 8%, (b) projected salary increases of 4.5% a year compounded annually, attributable to inflation, and (c) additional projected salary increases of 0.0% to 4.16% per year, depending on age, attributable to seniority/merit. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five year period. The unfunded actuarial accrued liability is being amortized as a level percent of projected payroll on an open basis over a period of 30 years.

Trend Information

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due.

Three-Year Trend Information
Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Accrued Liability (AAL) – Entry Age (a)	Actuarial Value Of Assets (b)	Unfunded AAL (UAAL) (a) – (b)	Funded Ratio (b/a)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((a-b)/c)
12/31/03	\$38,995,925	\$26,404,421	\$12,591,504	68%	\$6,753,347	186%
12/31/04	41,194,698	27,322,805	13,871,893	66	6,352,834	218
12/31/05	43,104,571	28,323,039	14,781,532	66	6,212,613	238

Schedule of Employer Contributions

Fiscal Year Ending September 30	Valuation Date December 31	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2004	2001	1,100,604	100	-
2005	2002	1,194,816	100	-
2006	2003	1,298,472	100	-

NOTE O – RISK MANAGEMENT:

Pathways is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Pathways was unable to obtain general liability, auto, and property insurance at a cost it considered to be economically justifiable. Pathways joined together with other units to participate in a public entity risk pool currently operating as a common risk management and insurance program. Pathways pay an annual contribution to the pool for its general

NOTE O – RISK MANAGEMENT (Continued):

insurance coverage. The agreement provides that the pool will be self-sustaining through member contributions and will reinsure through commercial companies for claims in excess of \$75,000 for each insured event.

Pathways continues to carry commercial insurance for Physician Malpractice and all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE P – OWNERSHIP:

Pathways membership is currently divided in proportion to each county's population, based on the 2000 U.S. Census, and is approximately 8.33%, 50.00%, 33.34%, and 8.33% for Alger, Marquette, Delta and Luce Counties respectively. The 2005 financial statements include 100% of the recorded assets of Pathways.

NOTE Q – OTHER POST EMPLOYMENT BENEFITS:

Pathways offers group medical insurance under various collective bargaining agreements covering substantially all employees and former employees of Pathways. The amount paid for former Pathways employees for the fiscal year ended September 30, 2006 was \$285,704 with 53 participants receiving benefits. This benefit is accounted for on the "pay-as-you-go" method, whereby Pathways is reporting the amounts paid as expenditures in the year the amount is paid for the benefit provided. For employees hired after January 1, 1998, Pathways no longer provides group medical insurance after separation from employment with Pathways.

NOTE R – FUND BALANCE/NET ASSET RESTATEMENT:

The following fund balance/net asset restatements were made as a result of discovering accounting errors and prior period adjustments to Medicaid amounts resulting from Department of Community Health's review of prior period information.

	Governmental <u>Activities</u>	General <u>Fund</u>	Special Revenue <u>Fund</u>
Net assets/fund balance, beginning of year	\$329,650	\$(1,475,027)	\$103,818
Prior period adjustment for contribution of Trust not previously recorded	-	-	-
Prior period adjustment for Medicaid Settlements	____(9,201)____	____(9,201)____	_____
NET ASSETS/FUND BALANCE, BEGINNING OF YEAR, AS RESTATED	<u>\$320,449</u>	<u>\$(1,484,228)</u>	<u>\$103,818</u>

REQUIRED SUPPLEMENTARY INFORMATION

Pathways

General Fund Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual For the Fiscal Year Ended September 30, 2006

	Budgeted Amounts		Actual	Variance with
	Original	Final	GAAP	Final Budget
			Basis	Positive
				(Negative)
REVENUES:				
State sources:				
Medicaid - Mental health	\$ 75,119,229	\$ 71,736,275	\$ 71,736,275	\$ -
Medicaid - Substance abuse	773,800	743,156	743,156	-
Medicaid - Child waiver	300,000	464,880	464,880	-
Medicaid fee for service	12,500	185,665	185,665	-
General funding	3,597,069	4,057,082	4,057,082	-
Contracts and grants:				
Mental health	276,904	332,327	332,327	-
Substance abuse	2,379,786	2,474,871	2,474,871	-
Charges for services:				
Client fees except Medicaid	543,000	1,607,892	1,607,892	-
Client fees work center	439,100	330,593	330,593	-
Local sources:				
County appropriations	600,592	600,972	600,972	-
County liquor tax	435,798	252,588	252,588	-
Contributions	10,300	28,770	28,769	(1)
Interest income	25,000	66,083	66,083	-
Other revenues	535,246	5,695,793	5,695,793	-
Less deductions from revenues:				
Donated services discount	-	(6,780,767)	(6,780,767)	-
Local match - QAAP Assessment	-	-	-	-
Local match - Medicaid draw down	728,717	726,038	726,038	-
Public Act 423 of 1980	-	-	-	-
TOTAL REVENUES	85,777,041	82,522,218	82,522,217	(1)
EXPENDITURES:				
Current operations:				
Personnel services	13,477,534	13,604,471	13,604,472	(1)
Personnel benefits	5,748,288	5,558,071	5,558,069	2
Board & committee	36,849	38,705	38,705	-
Office supplies and other	964,539	1,172,575	1,172,582	(7)
Contract services	10,998,546	13,415,250	13,415,248	2
Transportation	374,096	401,307	401,307	-
Building rental	566,713	620,791	620,791	-
Equipment rental	874,835	856,110	856,110	-
Repairs & maintenance	396,219	329,431	329,431	-
Utilities and related	425,700	309,659	309,658	1
Insurance	216,000	282,841	282,840	1
Staff development	142,136	177,885	177,884	1
Staff travel	298,067	255,737	255,737	-
Miscellaneous	4,883	11,181	11,181	-
QAAP assessment & other State obligations	3,074,786	2,643,833	2,643,832	1
Substance abuse programs	5,756,906	5,662,890	5,662,890	-
Other CMH - Medicaid	39,655,689	37,643,933	37,643,933	-
Capital outlay	-	-	-	-
TOTAL EXPENDITURES	\$ 83,011,786	\$ 82,984,670	\$ 82,984,670	\$ -

Pathways

General Fund Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual For the Fiscal Year Ended September 30, 2006

	Budgeted Amounts		Actual GAAP Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	<u>\$ 2,765,255</u>	<u>\$ (462,452)</u>	<u>\$ (462,453)</u>	<u>\$ (1)</u>
OTHER FINANCING SOURCES (USES):				
Transfers (out)	<u>(635,019)</u>	<u>(115,184)</u>	<u>(115,184)</u>	<u>-</u>
TOTAL OTHER FINANCING SOURCES (USES)	<u>(635,019)</u>	<u>(115,184)</u>	<u>(115,184)</u>	<u>-</u>
NET CHANGE IN FUND BALANCE	<u>2,130,236</u>	<u>(577,636)</u>	<u>(577,637)</u>	<u>(1)</u>
Fund balance, beginning of year	<u>(1,475,027)</u>	<u>(1,475,027)</u>	<u>(1,475,027)</u>	<u>-</u>
Prior period adjustment for Medicaid settlements	<u>-</u>	<u>-</u>	<u>(9,201)</u>	<u>(9,201)</u>
Fund balance, beginning of year, as restated	<u>(1,475,027)</u>	<u>(1,475,027)</u>	<u>(1,484,228)</u>	<u>(9,201)</u>
FUND BALANCE, END OF YEAR	<u><u>\$ 655,209</u></u>	<u><u>\$ (2,052,663)</u></u>	<u><u>\$ (2,061,865)</u></u>	<u><u>\$ (9,202)</u></u>

OTHER SUPPLEMENTARY INFORMATION

Pathways

Nonmajor Governmental Funds Combining Balance Sheet

September 30, 2006

	Special Revenue Fund Ray of Sunshine Fund	Debt Service Fund	Total Nonmajor Governmental Funds
ASSETS			
Cash and cash equivalents	\$ 6,253	\$ -	\$ 6,253
Investments	107,040	-	107,040
Accounts receivable - other	-	10,060	10,060
Due from other funds	1,113	-	1,113
Other assets	-	-	-
TOTAL ASSETS	<u>114,406</u>	<u>10,060</u>	<u>124,466</u>
LIABILITIES AND FUND BALANCE			
FUND BALANCE:			
Reserved for:			
Debt service	-	10,060	10,060
Unreserved	114,406	-	114,406
TOTAL FUND BALANCE	<u>114,406</u>	<u>10,060</u>	<u>124,466</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 114,406</u>	<u>\$ 10,060</u>	<u>\$ 124,466</u>

Pathways

Nonmajor Governmental Funds
Combining Statement of Revenues, Expenditures and Changes in Fund Balance

For the Fiscal Year Ended September 30, 2006

	Special Revenue Fund		Debt Service Fund		Total Governmental Funds
	Ray of Sunshine Fund				
REVENUES:					
Private contributions	\$ 16,012		-		\$ 16,012
Investment income	2,831		-		2,831
TOTAL REVENUES	18,843		-		18,843
EXPENDITURES:					
Current operations	8,255		-		8,255
Debt service:					
Principal	-		105,075		105,075
Interest and fiscal charges	-		10,109		10,109
TOTAL EXPENDITURES	8,255		115,184		123,439
EXCESS REVENUES OVER (UNDER) EXPENDITURES	10,588		(115,184)		(104,596)
OTHER FINANCING SOURCES (USES):					
Transfers in	-		115,184		115,184
Transfers (out)	-		-		-
TOTAL OTHER FINANCING SOURCES (USES)	-		115,184		115,184
NET CHANGE IN FUND BALANCE	10,588		-		10,588
Fund balance, beginning of year	103,818		10,060		113,878
Prior period adjustment for contributions	-		-		-
Fund balance, beginning of year, as restated	103,818		10,060		113,878
FUND BALANCE, END OF YEAR	\$ 114,406		\$ 10,060		\$ 124,466

Pathways

Internal Service Funds Combining Statement of Net Assets

September 30, 2006

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 3,035	\$ 4,723	\$ -	\$ 7,758
Investments	1,066,281	769,222	-	1,835,503
Due from local units	-	-	-	-
Due from other funds	-	-	-	-
Total current assets	<u>1,069,316</u>	<u>773,945</u>	<u>-</u>	<u>1,843,261</u>
Capital assets:				
Land and improvements	-	-	271,611	271,611
Buildings and building improvements	-	-	2,797,797	2,797,797
Vehicles	-	-	775,931	775,931
Office equipment	-	-	213,659	213,659
Information technology equipment	-	-	1,555,260	1,555,260
Accumulated depreciation	-	-	(1,599,936)	(1,599,936)
Total noncurrent assets	<u>-</u>	<u>-</u>	<u>4,014,322</u>	<u>4,014,322</u>
TOTAL ASSETS	<u>1,069,316</u>	<u>773,945</u>	<u>4,014,322</u>	<u>5,857,583</u>
LIABILITIES				
Current liabilities:				
Accounts payable	-	-	-	-
Due to other funds	-	-	690,870	690,870
Accrued payroll and related	173,330	-	-	173,330
Current maturities of long-term debt	-	-	502,795	502,795
Total current liabilities	<u>173,330</u>	<u>-</u>	<u>1,193,665</u>	<u>1,366,995</u>
Long-term liabilities:				
Compensated absences	1,437,894	-	-	1,437,894
Notes payable	-	-	2,820,657	2,820,657
Total long-term liabilities	<u>1,437,894</u>	<u>-</u>	<u>2,820,657</u>	<u>4,258,551</u>
TOTAL LIABILITIES	<u>1,611,224</u>	<u>-</u>	<u>4,014,322</u>	<u>5,625,546</u>
NET ASSETS				
Invested in capital assets, net of related debt	-	-	-	-
Restricted	-	773,945	-	773,945
Unrestricted	<u>(541,908)</u>	<u>-</u>	<u>-</u>	<u>(541,908)</u>
TOTAL NET ASSETS	<u>\$ (541,908)</u>	<u>\$ 773,945</u>	<u>\$ -</u>	<u>\$ 232,037</u>

Pathways

Internal Service Funds Combining Statement of Revenues, Expenses and Changes in Net Assets

For the Fiscal Year Ended September 30, 2006

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
OPERATING REVENUES:				
Charges for services	\$ 2,573,487	\$ -	\$ 842,458	\$ 3,415,945
Other	-	-	-	-
TOTAL OPERATING REVENUES	<u>2,573,487</u>	<u>-</u>	<u>842,458</u>	<u>3,415,945</u>
OPERATING EXPENSES:				
Personnel services	2,540,913	-	-	2,540,913
Other services and charges	-	-	-	-
Depreciation	-	-	647,532	647,532
TOTAL OPERATING EXPENSES	<u>2,540,913</u>	<u>-</u>	<u>647,532</u>	<u>3,188,445</u>
OPERATING INCOME (LOSS)	<u>32,574</u>	<u>-</u>	<u>194,926</u>	<u>227,500</u>
NON-OPERATING REVENUES (EXPENSES):				
Investment income	33,982	10,859	-	44,841
Interest expense	-	-	(149,639)	(149,639)
Loss on disposal of assets	-	-	(45,287)	(45,287)
TOTAL NON-OPERATING REVENUES (EXPENSES)	<u>33,982</u>	<u>10,859</u>	<u>(194,926)</u>	<u>(150,085)</u>
CHANGE IN NET ASSETS	<u>66,556</u>	<u>10,859</u>	<u>-</u>	<u>77,415</u>
Net assets, beginning of year	<u>(608,464)</u>	<u>763,086</u>	<u>-</u>	<u>154,622</u>
NET ASSETS, END OF YEAR	<u>\$ (541,908)</u>	<u>\$ 773,945</u>	<u>\$ -</u>	<u>\$ 232,037</u>

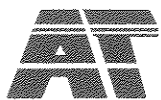
Pathways

Internal Service Funds Combining Statement of Cash Flows

For the Fiscal Year Ended September 30, 2006

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
CASH FLOWS FROM OPERATING ACTIVITIES:				
Cash received from charges for services	\$ 2,573,487	\$ -	\$ 842,458	\$ 3,415,945
Other operating revenues	-	-	-	-
Cash paid for operating expenses	(2,573,487)	-	-	(2,573,487)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	-	-	842,458	842,458
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:				
(Increase) decrease in due from other funds	-	-	-	-
Increase (decrease) in due to other funds	-	-	166,609	166,609
(Increase) decrease in due from local units	-	-	-	-
Transfers from local units	-	-	-	-
NET CASH PROVIDED (USED) BY NON-CAPITAL FINANCING ACTIVITIES	-	-	166,609	166,609
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:				
Acquisition and construction of capital assets	-	-	(533,879)	(533,879)
Proceeds on issuance of long-term debt	-	-	405,219	405,219
Interest payments on long-term debt	-	-	(149,639)	(149,639)
Principal payments on long-term debt	-	-	(730,768)	(730,768)
NET CASH (USED) BY CAPITAL FINANCING ACTIVITIES	-	-	(1,009,067)	(1,009,067)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Interest income	39,406	18,280	-	57,686
Net (increase) in investments	(36,576)	(746,656)	-	(783,232)
(Increase) in fair market value of investments	(5,424)	(7,421)	-	(12,845)
NET CASH PROVIDED BY INVESTING ACTIVITIES	(2,594)	(735,797)	-	(738,391)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,594)	(735,797)	-	(738,391)
Cash and cash equivalents, beginning of year	5,629	740,520	-	746,149
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 3,035	\$ 4,723	\$ -	\$ 7,758
RECONCILIATION OF OPERATING (GAIN) LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:				
Net operating income (loss)	\$ 32,574	\$ -	\$ 194,926	\$ 227,500
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:				
Depreciation expense	-	-	647,532	647,532
Changes in assets and liabilities:				
(Decrease) in accounts payable	-	-	-	-
(Decrease) in accrued sick and vacation	(18,722)	-	-	(18,722)
(Decrease) in accrued payroll and related	(13,852)	-	-	(13,852)
TOTAL ADJUSTMENTS	(32,574)	-	647,532	614,958
NET CASH PROVIDED FROM OPERATING ACTIVITIES	\$ -	\$ -	\$ 842,458	\$ 842,458

SUPPLEMENTAL REPORTS



ANDERSON, TACKMAN & COMPANY, P.L.C.

CERTIFIED PUBLIC ACCOUNTANTS

PARTNERS

JOHN W. BLEMBERG, CPA

ROBERT J. DOWNS, CPA, CVA

DANIEL E. BIANCHI, CPA

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS REQUIRED
BY GOVERNMENT AUDITING STANDARDS**

MICHIGAN
ESCANABA
IRON MOUNTAIN
KINROSS
MARQUETTE

WISCONSIN
GREEN BAY
MILWAUKEE

Members of the Board
Pathways
Marquette, Michigan

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2006, which collectively comprise Pathways' basic financial statements and have issued our report thereon dated May 29, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Pathway's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting, that, in our judgment could adversely affect Pathway's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described to management in a separate letter dated May 29, 2007.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above are material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pathways' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. These instances are described in a separate letter to management of Pathways dated May 29, 2007.

Members of the Board
Pathways
Marquette, Michigan

This report is intended solely for the information and use of management, others within the organization, the Board and other federal and state audit agencies and is not intended to be and should not be used by anyone other than these specified parties.

Anderson, Tackman + Company, PLLC
Certified Public Accountants

May 29, 2007

**PATHWAYS
FEDERAL FINANCIAL ASSISTANCE
For the Year Ended September 30, 2006**

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ANDERSON, TACKMAN & COMPANY, P.L.C.

CERTIFIED PUBLIC ACCOUNTANTS

PARTNERS

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ROBERT J. DOWNS, CPA, CVA

DANIEL E. BIANCHI, CPA

MICHIGAN
ESCANABA
IRON MOUNTAIN
KINROSS
MARQUETTE

WISCONSIN
GREEN BAY
MILWAUKEE

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

Members of the Board
Pathways
Marquette, Michigan 49855

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2006, which collectively comprise Pathways' basic financial statements and have issued our report thereon dated May 29, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Pathways' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of Pathways' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies that adversely affects the organization's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the organization's financial statements that is more than inconsequential will not be prevented or detected by the organization's internal control.

A material weakness is a significant deficiency, or combination of deficiencies that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the organization's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also

Members of the Board
Pathways
Marquette, Michigan 49855

considered to be material weaknesses.

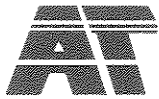
Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pathways' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, others within the organization, the Board, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Anderson, Tackman & Company, PLC
Certified Public Accountants

May 29, 2007



ANDERSON, TACKMAN & COMPANY, P.L.C.

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Members of the Board
Pathways
Marquette, Michigan 49855

Compliance

We have audited the compliance of Pathways with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2006. Pathways' major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Pathways' management. Our responsibility is to express an opinion on Pathways' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Pathways' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Pathways' compliance with those requirements.

In our opinion, Pathways complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2006.

Internal Control Over Compliance

The management of Pathways is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Pathways' internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express

Members of the Board
Pathways
Marquette, Michigan 49855

an opinion on the effectiveness of Pathway's internal control over compliance.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2006, and have issued our report thereon dated May 29, 2007. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the Pathways' basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of management, others within the organization, the Board, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Anderson, Tackman & Company, PLC
Certified Public Accountants

May 29, 2007

Pathways
Schedule of Expenditures of Federal Awards
For the year ended September 30, 2006

Federal Grantor/Pass Through Grantor Program Title	Federal C.F.D.A. Number	Project Number	Project Period	Award Amount	Federal Expenditures
U.S. Department of Health & Human Services:					
Passed through the Michigan Department of Community Health:					
State Incentive Grant (SIG)	93.243	20061010	10/1/05-9/30/06	200,795	200,795
Marquette County Substance Abuse & Violence Prevention Coalition	93.276	1 H79 SP1354-01	9/30/2005-9/29/2010	100,000	100,000
Omnibus Budget Reconciliation Act	93.778	N/A	10/1/05-9/30/06	81,130	81,130
Family Psychoeducation	93.958	20061249	10/1/05-9/30/06	\$ 80,000	\$ 54,729
Parent Management Training - Oregon Model	93.958	20061249	10/1/05-9/30/06	25,000	25,000
Juvenile Justice Diversion	93.958	20060899	10/1/05-9/30/06	62,475	19,606
SED Respite Services	93.958	20060899	10/1/05-9/30/06	4,676	1,673
Dial-a-Ride	93.958	20060899	10/1/05-9/30/06	12,000	11,140
Brantley Drop-In Center	93.958	20060899	10/1/05-9/30/06	4,100	4,100
					<u>116,248</u>
Block Grant for Prevention and Treatment of Substance Abuse:					
Substance Abuse Coordinating Agency	*	20061010	10/1/05-9/30/06	211,000	94,950
Prevention	*	20061010	10/1/05-9/30/06	748,682	604,509
Treatment	*	20061010	10/1/05-9/30/06	1,064,500	880,253
Women and Family	*	20061010	10/1/05-9/30/06	119,510	95,608
					<u>1,675,320</u>
					<u>2,173,493</u>
Total U.S. Department of Health & Human Services					
U.S. Department of Housing & Urban Development:					
Passed through the Michigan Department of Community Health					
Shelter Plus Care	14.238	20060750	10/1/05-9/30/06	34,836	\$ 5,191
					<u>5,191</u>
Total U.S. Department of Housing & Urban Development					
TOTAL FEDERAL FINANCIAL ASSISTANCE					<u>\$ 2,178,684</u>

* Denotes a major program

PATHWAYS
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended September 30, 2006

NOTE A - BASIS OF PRESENTATION:

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Pathways and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B - OVERSIGHT AGENCY:

The U.S. Department of Health and Human Services is the current year's oversight agency for the single audit as determined by the agency providing the largest share of Pathways' federal financial assistance.

NOTE C - SUBRECIPIENTS:

Of the federal expenditures presented in the schedule, Pathways provided federal awards to subrecipients as follows:

<u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Amount Provided to Subrecipient</u>
Block Grant for Prevention and Treatment of Substance Abuse:		
Prevention	93.959	\$604,509
Treatment	93.959	880,253
Women and Family	93.959	95,608
Substance Abuse and Mental Health Services- Projects of Regional and National Significance:		
State Incentive Grant (SIG)	93.243	200,795

PATHWAYS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended September 30, 2006

Section I - Summary of Auditors' Results

Financial Statements

- Type of auditors' report issued: Unqualified
- Internal control over financial reporting:
 - No significant deficiencies were identified.
 - No material weaknesses were identified.
- No noncompliance items material to the financial statements were identified.

Federal Awards

- Internal Control over major programs:
 - No significant deficiencies were identified.
 - No material weaknesses were identified.
- Type of auditors' report issued on compliance for major programs: Unqualified.
- Audit findings that are required to be reported in accordance with Circular A-133, Section .510(a): None.

Major Program

- The program tested as a major program was:
 - Block Grant for Prevention and Treatment of Substance Abuse CFDA# 93.959
- Dollar threshold used to distinguish between Type A and Type B programs: \$300,000.
- Auditee qualified as low-risk auditee? Yes.

Section II - Financial Statement Findings

- THE FOLLOWING REPORTABLE CONDITIONS WERE NOTED:

06-1 Condition: The accounting system at Pathways contains general ledger accounts that are not being reconciled on a timely basis, of which the accounts receivable system is the most significant.

Criteria: Internal controls should be in place to ensure general ledger accounts are reconciled timely.

Effect: The general ledger contains the accounts and records which are the basis for the preparation of the interim financial statements and for the financial statements to be free of a material error or irregularity the general ledger accounts need to be reconciled timely.

Recommendation: Management should reconcile the accounts receivable general ledger accounts on a monthly basis and any adjustments to be made should be processed timely.

Management Response: Management concurs and will reconcile the module on a monthly basis.

PATHWAYS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended September 30, 2006

- THE FOLLOWING REPORTABLE CONDITIONS WERE NOTED:

06-2 Condition/Criteria: At September 30, 2006 Pathways had an unrestricted equity deficit in two of their funds, as shown in Footnote K to the financial statements. Public Act 275 of 1980 requires that all deficits in any fund balance of local units be disclosed and enumerated upon in the Footnotes of the financial statements. In accordance with the Act, a corrective action plan for the deficit is required to be filed with the State Treasurer within 90 days of the end of the fiscal year. Pathways has not filed such a plan for the 2006 fiscal year.

Effect: Pathways is not in compliance with State Law.

Cause of Condition: Failure of operating revenues to cover operating expenditures in the current and prior years.

Recommendation: Pathways needs either to increase operating revenues or decrease operating expenditures in the future.

Management Response: Management concurs and will file the deficit plan within 90 days in the future.

Section III - Federal Award Findings and Questioned Costs

- There were no findings and/or questioned costs identified.

PATHWAYS
SCHEDULE OF PRIOR YEAR FEDERAL AWARD FINDINGS AND QUESTIONED COSTS
For the Year Ended September 30, 2006

There were no prior year findings or questioned costs relating to
Pathway's major programs.